BEFORE THE PUBLIC UTILITIES COMMISSION OF THE

STATE OF CALIFORNIA

In the Matter of the Application of Southern California Gas Company (U 904 G), San Diego Gas & Electric Company (U 902-G), and Southern California Edison Company (U338-E) for Approval of Changes to Natural Gas Operations and Service Offerings	)))))))	A. 06-08-026

OPENING BRIEF OF SOUTHERN CALIFORNIA EDISON COMPANY (U338-E)

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I.

INTRODUCTION

Pursuant to the procedural schedule set by Administrative Law Judge Pulsifer in the above-referenced proceeding, Southern California Edison Company ("SCE") hereby submits its Opening Brief, which urges the Commission to approve the changes to the operational practices and services offered by Southern California Gas Company ("SoCalGas") and San Diego Gas and Electric Company ("SDG&E") as a result of the May 30, 2006 settlement agreement between SCE, SoCalGas, and SDG&E (referred to herein as the "Omnibus Settlement Agreement") and of the January 4, 2006 agreement between SoCalGas, SDG&E, Sempra Energy, Sempra Energy Affiliates, and the plaintiffs in what is commonly referred to as the Continental Forge class action lawsuit (hereinafter referred to as the "Continental Forge Settlement Agreement").

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II.

BACKGROUND

SCE is one of the largest noncore customers of SoCalGas, purchasing over $5 billion a year in direct and indirect natural gas costs.[1] For approximately the past 20 years, SCE was one of the chief proponents of reform to the California natural gas industry through its participation in the Commission's efforts to restructure the natural gas industry. Such reforms were considered and implemented through the Gas Industry Restructuring proceeding,[2] which led to a series of proposed market reforms in the "Most Promising Options" decision,[3] the Comprehensive Settlement Agreement,[4] and the firm access rights proceeding.[5] SCE was also a key and very active participant in the SoCalGas gas cost incentive mechanism ("GCIM") proceedings[6] and in the Border Price OII,[7] where SCE demonstrated (1) that SoCalGas had the ability and the incentive to affect border prices through its control of its intrastate transportation and storage assets and its interstate transportation assets controlled through SoCalGas' core procurement function, and (2) that SoCalGas had the ability and incentive to conduct operations in ways that could benefit its shareholders at the expense of other market participants and electric consumers.[8]

SoCalGas' actions during the energy crisis of 2000-2001 were at issued in a class action lawsuit in San Diego Superior Court, which resulted in the January 4, 2006 Continental Forge Settlement Agreement by which SoCalGas agreed to seek Commission approval of a series of market reforms. SCE supports the market reforms proposed in the Continental Forge Settlement

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1 Further, SCE expects its direct procurement of gas supplies to increase due to future local generation requirements, the operation of the Mountainview Power Plant, and the eventual termination of the California Department of Water Resources' power purchase agreements that will have to be replaced by SCE procurement. Exhibit 47, Direct testimony of Pickett (SCE), page 2.

2 OIR 98-01-011.

3 Decision No. 99-07-015.

4 Decision No. 02-12-018.

5 Application No. 04-12-004.

6 See, e.g., Application No. 00-06-023 (GCIM Year 6).

7 OII 02-11-040 (Border Price OII).

8 Exhibit 47, Direct of Pickett (SCE), pages 3 – 4.

and supports SoCalGas and SDG&E's efforts to obtain Commission approval of the market reforms set forth in that agreement.

Since the Commission's partial deregulation of California's natural gas utilities that was implemented in 1991, SCE has expended a considerable amount of time and resources before the Commission advocating additional market reforms through various proceedings, most recently in the GCIM proceedings and in the Border Price OII. Eventually, SCE's involvement in the GCIM and the Border Price OII resulted in negotiations with SoCalGas and SDG&E to address the issues raised by SCE at the Commission and in various other forums. Those negotiations ultimately led to the execution of the May 30, 2006 Omnibus Settlement Agreement. The Omnibus Settlement mitigates concerns raised by SCE in the Border Price OII, the Sempra Affiliate Investigation,[9] and every SoCalGas GCIM proceeding since 1999. Through negotiation with SoCalGas and SDG&E, SCE believes it has achieved a series of market reforms that will lead to a more transparent and competitive natural gas market in Southern California. SCE believes that the testimony and evidence in this proceeding demonstrates that the Omnibus Settlement will reduce costs for SCE's ratepayers and ultimately benefit the California natural gas market as a whole.[10] As such, SCE urges the Commission to approve the tariff proposals set forth in this application that will implement the provisions agreed to in the Omnibus Settlement Agreement and the market reform provisions in the Continental Forge Settlement Agreement as a significant step toward ensuring in the future that the market for natural gas in southern California will be more efficient and transparent.

SCE urges the Commission to adopt tariff proposals implementing the Omnibus Settlement Agreement and implementing the market reforms set forth in the January 4, 2006 Continental Forge Settlement Agreement. As with any settlement, the Omnibus Settlement Agreement represents a balancing of interests and a compromise among the parties on various

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[9] OII 03-02-033.

[10] Exhibit 47, Direct Testimony of Pickett (SCE), page 5; Exhibit 19, Direct Testimony of Morrow (SoCalGas/SDG&E), page 1.

issues. The combined market reforms set forth in the Continental Forge Settlement Agreement and the Omnibus Settlement Agreement will result, on balance, in a natural gas market that will benefit all natural gas customers in California (1) by fostering more efficient and competitive intrastate transmission and storage markets, (2) by instituting more equitable and efficient balancing rules, and (3) by increasing the transparency of the market for natural gas.[11] Each of the parties to the Omnibus Settlement Agreement would likely continue to advocate different positions in the absence of the settlement, but each supports the package of elements reflected in the agreement.[12] Given the substantial "gives and takes" that occurred during the negotiation process, SCE strongly urges the Commission to adopt all of the proposed tariff changes to implement the market reforms set forth in the Omnibus Settlement Agreement and the Continental Forge Settlement Agreement. These proposed changes represent a balanced outcome as the result of extensive negotiations. A limited implementation of the proposed market reforms runs the risk that unbalanced and unintended consequences and/or market reform shortcomings will substantially limit the effectiveness of those settlements.[13] Individual elements of the settlement by themselves do not tell the entire story, and these carefully negotiated settlements need to be considered as one cohesive resolution.[14]

Notably, the parties to the Continental Forge Settlement Agreement and the Omnibus Settlement Agreement represent a broad spectrum of gas and electricity consumers, and their negotiation and execution of these settlement agreements reflects the delicate balancing of a multiple of interests.[15] While one party in this proceeding, DRA, expressed in the evidentiary hearings concern regarding not being a party to the negotiations on the Omnibus Settlement Agreement,[16] DRA has not historically demonstrated the same level of concern about SoCalGas' exercise of market power in natural gas markets and has not participated as actively as SCE in

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[11] Exhibit 47, Direct Testimony of Pickett (SCE), page 9.
[12] Exhibit 47, Direct Testimony of Pickett (SCE), page 5.
[13] Exhibit 47, Direct Testimony of Pickett (SCE), page 9.
[14] Exhibit 19, Direct Testimony of Morrow (SoCalGas/SDG&E), page 4.
[15] Exhibit 19, Direct Testimony of Morrow (SoCalGas/SDG&E), page 7.
[16] Tr., Vol. 3, pages 425-426 (Morrow, SoCalGas/SDG&E) (May 10, 2007).

both the SoCalGas' GCIM proceedings as well as the Border Price OII. Further, the Commission should be mindful that SCE, SoCalGas and SDG&E have a duty as public utilities to provide reliable service to all their customers (core and noncore) and to provide such service to all of their customers.[17] The Applicants assert that the Omnibus Settlement Agreement properly reflects this balance of interests.[18]

III.

THE OMNIBUS SETTLEMENT AGREEMENT IS A STEP IN THE RIGHT DIRECTION IN ADDRESSING SCE'S CONCERNS OVER SOCALGAS' MARKET POWER

The Omnibus Settlement Agreement addresses a number of concerns expressed by SCE over the past decade regarding SoCalGas' exercise of market power in the market for natural gas in California. One of SCE's specific concerns is that SoCalGas has a monopoly over gas storage facilities in southern California.[19] SCE's concern is that the lack of third party providers and the lack of a secondary market for storage services permit SoCalGas to set the terms of storage services in southern California with impunity. In other proceedings, SCE has expressed its belief that these conditions have had and could continue to have an adverse impact on the forward market price for natural gas and electricity.[20] SCE is also concerned that, absent the reforms proposed in this proceeding, SoCalGas' control over the use of large quantities of gas in storage provides a mechanism by which the price of gas at the southern California border could be manipulated.[21]

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[17] Exhibit 71, Direct Testimony of Sabino (DRA), page 5 (citing Public Utilities Code section 451). SoCalGas' obligation to represent all customers (core and noncore) stands can be contrasted with DRA's apparent efforts to represent core customers only (as illustrated in its direct testimony, which expresses concern only for core customers), notwithstanding DRA's legal obligations to represent all customers (i.e., core and noncore). See Section 309.5 of the California Public Utilities Code. See also Tr., Vol. 7, page 1078, lines 21-22 (Dr. Alexander, SCE) (May 17, 2007).

[18] Tr, Vol. 7, page 1079, lines 4-8 (Dr. Alexander, SCE) (May 17, 2007).

[19] Exhibit 47, Direct Testimony by Pickett (SCE), page 6.

[20] Exhibit 47, Direct Testimony by Pickett (SCE), page 6.

[21] Exhibit 47, Direct Testimony by Pickett (SCE), page 6.

The Omnibus Settlement Agreement is a step in the right direction in resolving SCE's concerns. The Omnibus Settlement Agreement establishes maximum prices that SoCalGas can assess for the sale of storage services and improves the way in which storage is made available to existing customers. Specifically, under the Omnibus Settlement Agreement:

- Pricing for storage inventory, injection, and withdrawal capacity will be unbundled and subject to annual price caps,[22] thus providing a clear signal to the market regarding the price of each service separate from a bundled package of storage services.[23]
- SoCalGas and SDG&E's commitment to provide 51 Bcf of inventory capacity to the unbundled storage program will increase the amount of capacity available to the constrained unbundled storage markets and provide unbundled storage customers (core and noncore) with more certainty about the amount of inventory capacity available to purchase.[24]
- SoCalGas will develop a Storage Development Plan to increase storage capacity. Incremental capacity would be made available to customers on an open access basis.[25]
- SoCalGas will make available all unutilized access and storage capacity on an interruptible basis,[26] thus increasing the usability of available storage.
- Rule 39 is modified to include any future third party storage providers that connect to the utility system to provide customers with the potential ability to use

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[22] The rate caps for storage services are $1.63/dth for storage inventory capacity; $60/dthd for storage injection capacity, and $30/dthd for storage withdrawal capacity. See Sheet 2 of proposed G-TBS tariff, which is part of Exhibit 19, Appendix B to Direct Testimony of Morrow (SoCalGas/SDG&E). See also Exhibit 56, Direct Testimony of Lenart (SoCalGas/SDG&E), p. 3, where SoCalGas indicates that the current storage inventory costs for customers would be 74 cents per therm based on current customer throughput.

[23] Exhibit 19, Direct Testimony of Morrow (SoCalGas/SDG&E), page 8.

[24] Exhibit 19, Appendix B, Section 9, page B-3.

[25] Exhibit 8, Direct Testimony of Watson (SoCalGas/SDG&E), p. 5.

[26] Exhibit 19, Appendix B, Omnibus Settlement Agreement, Section 2, page B-1.

additional supply options to manage their procurement, transportation, and storage needs.[27]

- SoCalGas will add a fifth nomination cycle, permitting companies to withdraw gas from storage at the end of the day in order to help them bring their use of the system into balance.[28]

Additionally, SCE supports the market reforms in the Continental Forge Settlement, which establishes physical monthly storage inventory targets for the core reservation that will provide limits on fluctuations in injection by SoCalGas, thus limiting the potential for such fluctuations to adversely impact forward gas prices.[29] As a result, market participants will have a clear understanding about how the utilities will manage inventory levels for core customers during the storage injection season.[30]

Second, another area of concern was the existing structure of SoCalGas' GCIM. SCE believes that the GCIM provided incentives for SoCalGas to take actions to affect southern California Border gas prices in a manner detrimental to the interests of SCE's customers and the market.[31] Specifically, SCE was concerned that, without change, the GCIM provided an incentive for SoCalGas to influence southern California border prices to realize shareholder gains at the expense of other market participants and gas and electric ratepayers.[32]

The Omnibus Settlement Agreement is a step in the right direction in regard to addressing several of SCE's concerns of the GCIM. For instance, as discussed in detail in Section V of this Opening Brief, the financing hedging activities for the winter months will be removed from the calculation of the benchmark. That will eliminate potential incentives to

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[27] Exhibit 19, Direct Testimony of Morrow (SoCalGas/SDG&E), page 8.
[28] Exhibit 19, Appendix B, Omnibus Settlement Agreement, Section 3, page B-1.
[29] Exhibit 19, Appendix A, Section II.A.1, page A-2, which provides that SoCalGas core physical storage inventory targets will be established for each month during the April – October injection season. See Exhibit 2, Direct of Van Lierop (SoCalGas/SDG&E), pages 4 – 5 for details of the agreed upon inventory targets.
[30] Exhibit 19, Direct Testimony of Morrow (SoCalGas/SDG&E), pages 7 and 8.
[31] Exhibit 47, Direct Testimony of Pickett (SCE), page 6.
[32] Exhibit 47, Direct Testimony of Pickett (SCE), page 6.

manipulate the market prices to make the hedges "profitable."[33] In addition, the Omnibus Settlement Agreement addresses another of SCE's concerns by requiring SoCalGas to transfer the operation of the utility Hub Services and system reliability procurement from the core procurement function to the system operations function.[34] One of the key principles advocated by SCE in the Omnibus Settlement Agreement was that there should be a level playing field for core and noncore customers by treating core customers, where possible, in same manner as noncore customers. Removing Hub services from core responsibility and control will provide a clear line of responsibility between these distinct utility functions. This will permit the core procurement function to operate on the transportation system on a basis that is functionally equivalent to other customers. It will also mitigate the ability and any incentive SoCalGas might have to manipulate the natural gas market to increase the demand for Hub services so as to provide a profit to SoCalGas through the shareholder award portion of its GCIM.

Third, SCE is generally concerned about the current lack of transparency of SoCalGas' operations.[35] SoCalGas is an interstate pipeline exempt from federal regulation under the Hinshaw amendment to the Natural Gas Act. Interstate pipelines are required to completely separate transportations services from any natural gas marketing functions in which pipeline affiliates may be engage. SCE believes that SoCalGas' procurement and operations functions are, absent the implementation of the settlement provisions through this application, not properly unbundled and effectively provide the core procurement function with a competitive information advantage over other market participants with respect to the management of utility Hub Services program and parks and loans.[36]

The Omnibus Settlement Agreement is a step in the right direction in that a key principle to the Agreement is the increase in market transparency and information disclosure. The

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33 Exhibit 47, Direct Testimony of Pickett (SCE), pages 7-8; Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pages 18-21.

34 Exhibit 8, Direct Testimony of Watson (SoCalGas/SDG&E), page 6.

35 Exhibit 47, Direct Testimony of Pickett (SCE), page 6.

36 Exhibit 47, Direct Testimony of Pickett (SCE), page 6; Exhibit 8, Direct Testimony of Watson (SoCalGas/SDG&E), pages 16-18.

Omnibus Settlement Agreement expands upon the public reporting requirements that are contained within the Continental Forge Settlement. Such reporting requirements will significantly improve the transparency of the operations and market functions on the SoCalGas system.[37] The Continental Forge Settlement Agreement provides that the following information be posted on the Electronic Bulletin Board:

- Index of customer contractual access rights for firm receipt points and associated capacity.
- Index of customer contractual storage rights – inventory, daily withdrawal, injection capacity.
- Hub positions, volumes loaned, volumes parked, withdrawal schedules for volumes parked, repayment schedules of loans.
- Planned and actual outages.
- Daily total storage inventory positions.
- Weekly core storage inventory positions.

In addition, the enhanced reporting requirements from the Omnibus Settlement Agreement include:

- The posting of the following information on the electronic bulletin board by SoCalGas: (1) current and day ahead receipts scheduled, (2) maximum capacity available to be scheduled at each receipt point on the mainline and third party storage interconnections, (3) imbalance volumes traded among all customers.[38]
- Annual publication by SoCalGas of the capacity and forecasted average daily usage of combined backbone transmission system for the upcoming year.[39]

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[37] Exhibit 47, Direct Testimony of Pickett (SCE), page 8.

[38] Exhibit 19, Appendix B, Omnibus Settlement Agreement, Section 1, page B-1. See Direct of Watson (SoCalGas/SDG&E), page 14.

[39] Exhibit 19, Appendix B, Omnibus Settlement Agreement, Section 11, page B-3.

As a result, SCE believes that these enhanced reporting requirements aim to separate further the core procurement and gas operations functions so that the core would operate in the market in a fashion more similar to how noncore customers are required to operate.

Finally, SCE, in entering into the Omnibus Settlement, was concerned about improving the transportation services available to customers.[40] The Omnibus Settlement Agreement contains provisions that benefits customers by:

- Introducing a 5th nomination cycle (as noted previously), which provides customers with a new feature to help manage transportation imbalances.[41]
- Assigning the SDG&E/SoCalGas System Operator (as opposed to the SoCalGas Gas Acquisition Department which has this current responsibility) with the on-going responsibility to ensure that gas supplies are delivered at the required locations to maintain system reliability.[42]
- Introducing an enhanced imbalancing trading system for those customers with imbalance or storage accounts.[43]
- Requiring SoCalGas to make available all unutilized access and storage capacity on an interruptible basis.[44]
- Implementing protocols designed to facilitate third party interconnections to the SoCalGas/SDG&E systems and requirements for SoCalGas to perform system expansion studies and to conduct industry meetings if system utilization exceeds a certain threshold that would facilitate system expansions, including third party connections.[45]

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[40] Exhibit 47, Direct Testimony of Pickett (SCE), page 6.
[41] Exhibit 19, Appendix B, Omnibus Settlement Agreement, Section 3, page B-1.
[42] Exhibit 29, Direct Testimony of Schwecke (SoCalGas/SDG&E), pages 3 – 4.
[43] Exhibit 29, Direct Testimony of Schwecke (SoCalGas/SDG&E), pages 12 – 14.
[44] Exhibit 19, Appendix B, Omnibus Settlement Agreement, Section 2, page B-1.
[45] Exhibit 19, Appendix B, Omnibus Settlement, Sections 10-14, pages B-3 and B-4, which provides for the expansion of intrastate backbone transmission and the expansion of receipt points.

All of these elements of the settlements are designed to increase the efficiency and reliability of the gas infrastructure system that serves southern California.

For the balance of this Opening Brief, SCE addresses two specific areas of concerns raised by parties: (1) the proposed combined core inventory level, and (2) the removal of hedges from SoCalGas' gas cost incentive mechanism.

IV.

THE COMMISSION SHOULD SET THE COMBINED CORE INVENTORY LEVEL AT 70 BCF

The Omnibus Settlement provides that SoCalGas and SDG&E combine their core procurement portfolios and gas acquisition management and that the storage inventory reservation for the SoCalGas and SDG&E core portfolio, after combination, will be 70 Bcf, with a corresponding injection of 327 MMcfd.[46] The Applicants also propose that the core's peak winter withdrawal be set at 2,225 MMcf/d. Because of the correlation between inventory capacity and injection capacity,[47] one of the key issues for the Commission to determine in this proceeding is whether a combined core storage inventory level of 70 Bcf, as proposed by the Applicants, is sufficient for core reliability. The Applicants' proposal and DRA's competing proposal are set forth below:

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[46] Exhibit 19, Appendix B, Omnibus Settlement, Section 7 on page B-2.

[47] That is, the less inventory capacity one holds (as proposed by the applicants), the less injection capacity one needs. SoCalGas has been able to fill the70 Bcf of capacity without serious problem with 327 MMcf/day of injection capacity, and it is reasonable to assume that 327 MMcf/day of injection would be adequate if the Commission aggress with the proposed 70 Bcf of inventory for the combined core. Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pages 3-4.

Table 1[48]
Core Storage Inventory Capacity

SoCalGas Current	**SDG&E Current**	**Combined Current**	**Settlement (combined core)**	**DRA's position (combined core)**
70 Bcf 4 Bcf for CARE[49]	9 Bcf	83 Bcf	70 Bcf	83 Bcf

Table 2[50]
Core Storage Injection

SoCalGas Current	**SDG&E Current**	**Combined Current**	**Settlement (combined core)**	**DRA's position (combined core)**
327 MMcf/d	42 MMcf/d	369 MMcf/d	327 MMcf/d	368 MMcf/d

Table 3[51]
Core Storage Withdrawal

SoCalGas Current	**SDG&E Current**	**Combined Current**	**Settlement (combined core)**	**DRA's position**
1935 MMcf/d	297 MMcf/d	2232 Bcf	2,225 MMcf/d	2,225 MMcf/d

As can be seen in Tables 1 – 3 above, DRA proposes that the core storage inventory level (along with the corresponding proposed injection and withdrawal levels) should basically remain the sum of SoCalGas and SDG&E's separate portfolios.[52] DRA fears that reducing the gas storage inventory for the combined portfolio would result in less gas available for withdrawal during the higher cost winter heating system.[53]

As a threshold matter, Applicants emphasize that they share DRA's belief that the core must have an adequate storage inventory level so that the utilities can serve the core adequately, reliably, and at the lowest reasonable cost.[54] In this proceeding, the Applicants have demonstrated, through expert testimony and analysis, that 70 Bcf is more than sufficient to meet the combined core's reliability needs. And, just as it is important for the core to have an

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48 Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pages 2-3.
49 Of the 4 Bcf storage inventory capacity reserved for core, 2.75 bcf core storage inventory is currently banked for the core.
50 Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pages 2-3.
51 Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pages 2-3.
52 Exhibit 71, Direct Testimony of Sabino (DRA).
53 Exhibit 71, Direct Testimony of Sabino (DRA).
54 Exhibit 71, Direct Testimony of Sabino (DRA).

adequate storage level, it is also inefficient and harmful to assign the core more capacity than it needs. The evidentiary record demonstrates that a combined core inventory level of 83 Bcf, as proposed by DRA, is excessive and unnecessary.

A. A Combined Core Inventory Level of 70 Bcf is More Than Sufficient To Meet The Core's Needs for Reliability

As discussed earlier, the proposed consolidated portfolio of SoCalGas and SDG&E will have, among other assets, 70 Bcf of storage inventory to serve the combined core procurement load.[55] SoCalGas' expert witness, Mr. Paul Goldstein, has testified that, based on his experience in the Gas Acquisition Department and based on SoCalGas' review, 70 Bcf is more than adequate to handle the addition of the SDG&E core load to the SoCalGas load:

> Q. And, I just want to understand if SoCalGas and SDG&E have considered what they would do if it turns out that this is not enough, they have not reserved enough assets to serve core reliability.
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> A. I guess under most, if not all, scenarios we've thought of that would not be the case. . . . [W]e've had 70 Bcf at least for most of the time period I've been with the gas acquisition. And the additional 13 percent or so of load or 15 percent [associated with SDG&E] I don't consider having a large impact to the assets required to serve that. I think we can --- the 70 Bcf and the 327, we can certainly handle additional load. . . .
> . . . . . but I think 70 Bcf and the 327 reliability would not – on a cold year basis – reliability would not be impacted by the total number for the combined portfolio."[56]

SCE witness Dr. Alexander performed a detailed analysis on the amount of core storage needed for reliability. In addition to storage, Dr. Alexander observed that core reliability needs can be met through a variety of ways:[57] (1) firm interstate supplies, (2) purchases of gas at the border from marketers or other end use customers,[58] (3) purchases of gas at the basin, which are

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[55] Exhibit 35, Direct Testimony of Goldstein (SoCalGas).

[56] Tr., Vol. 5, page 787, line 28 to page 788, line 24 (Goldstein, SoCalGas/SDG&E) (May 15, 2007).

[57] Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pages 5 – 9.

[58] In GCIM year 11, 15% of SoCalGas' requirements were made through purchases at the border. Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pages 6-7.

brought into the SoCalGas system using interruptible capacity on the interstate pipelines;[59] (4) purchases of gas at the basin and which are brought into the SoCalGas system using firm transportation capacity releases by other shippers on the interstate pipelines, (5) purchases of gas in storage held by marketers or other end-use customers. Also, in the unlikely event that the core has insufficient gas supplies available to it, Dr. Alexander noted that SoCalGas' Rule 23 permits the Gas Acquisition Unit to confiscate gas from noncore customers if necessary to avid curtailing core customers.[60]

Dr. Alexander's analysis showed that, assuming 15% of core gas demand was purchased at the border[61] and that SoCalGas made full use of the 1,135 MMcf/day of firm capacity held by the combined core, the combined core could be reliability served using less than 70 Bcf of firm storage even without using the other methods listed above.[62] Specifically, core's demand could be served with as little as 64 Bcf of firm storage for 2007 and can easily be served through 2016 with the 70 Bcf reserved for the combined core proposed by the Applicant.

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[59] 169 Bcf was brought in through this method in 2006. Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), page 8.

[60] Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), page 9.

[61] In GCIM year 11, 15% of SoCalGas' requirements were made through purchases at the border. Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pages 6-7.

[62] Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pages 6 – 7; Exhibit 61, Errata to MSA-1 of the Rebuttal Testimony of Dr. Alexander (SCE).

Table 4[63]
Annual Combined Winter Throughput Not Met Through
Firm Transportation or Border Purchases

Year	SoCalGas & SDG&E Combined Winter Av. Daily Mcf/d	Less 15% Border Purchases Mcf/d	Average Winter Daily Throughput Not Met with Border Purchases Mcf/d	Combined Firm Interstate Pipeline Capacity Mcf/d	Annual Winter Throughput Not Met by Firm Transportation or 15% Border Purchases Mcf/d	Annual Winter Throughput Not Met by Firm Transportation or 15% Border Purchases Bcf
2006	1,823	273	1,549	1,135	414	62.57
2007	1,835	275	1,560	1,135	425	64.19
2008	1,839	276	1,563	1,135	428	64.69
2009	1,842	276	1,566	1,135	431	65.07
2010	1,849	277	1,571	1,135	436	65.91
2011	1,854	278	1,575	1,135	440	65.51
2012	1,857	279	1,579	1,135	444	66.98
2013	1,862	279	1,582	1,135	447	67.57
2014	1,866	280	1,586	1,135	451	68.11
2015	1,873	281	1,592	1,135	457	68.98
2016	1,880	282	1,598	1,135	463	69.90

In contrast to SCE's testimony, DRA did not present any analysis that 83 Bcf is the right level for the combined core inventory. As indicated above, DRA has simply taken the sum of SoCalGas and SDG&E's existing, separate portfolios without providing the record any analysis as to whether such sum is appropriate. Moreover, DRA did not make any analysis of the efficiencies that could be achieved through core consolidation. DRA provided no analysis to determine whether SoCalGas could accommodate SDG&E's core within the current 70 Bcf inventory level held by SoCalGas' core. Indeed, DRA's current support for a combined 83 Bcf core inventory level is inconsistent with its testimony in SoCalGas and SDG&E's core consolidation proceeding, where DRA (or ORA, as it was previously called) acknowledged that there would be storage efficiencies as a result of core consolidation:

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[63] Data from Exhibit 61, Errata to MSA-1 of the Rebuttal Testimony of Dr. Alexander (SCE).

"First, there are efficiencies associated with the consolidation of these functions. ORA agrees that consolidation will produce the following benefits identified by the applicants: 1) more efficient gas purchasing resulting in lower commodity costs because of the greater amount of natural gas being procured and greater diversity of demand being served, 2) **more efficient use of storage and capacity assets,** 3) greater efficiency in the cost of managing the utilities' gas procurement activities, and 4) regulatory efficiency."[64]

Moreover, DRA's current proposal is also inconsistent with DRA's agreement in the Comprehensive Settlement Agreement that SoCalGas needed only 35 Bcf o storage inventory for reliability. Specifically, parties to the Comprehensive Settlement Agreement, such as DRA, agreed that SoCalGas' core storage inventory of 70 Bcf should be reduced to 55 Bcf, of which 35 Bcf should be allocated for reliability and balancing.[65] Adding the approximately 4.5 Bcf of storage inventory needed for reliability for SDG&E's core[66] would mean that approximately 40 Bcf is needed for reliability for both SoCalGas and SDG&E's core.[67]

Table 5
Core Inventory Level Needed For Reliability

	Core Reliability and/or Balancing	Core Arbitrage
SoCalGas	35 Bcf[68]	20 Bcf[69]
SDG&E	4.5 Bcf[70]	4.5 Bcf.[71]
Total Combined Core Inventory Needed For Reliability	**39.5 Bcf**	

[64] Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), page 4 (quoting ORA's testimony from A. 01-01-021) (emphasis added).

[65] Decision No. 01-12-018, Section III.D(2), mimeo p. 58. Dr. Alexander has indicated that the three purposes of storage inventory are reliability, balancing, and price arbitrage. Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), page 5. Given the settling parties' view that 35 of the 55 Bcf would be used for reliability and balancing, 20 Bcf could be used for price arbitrage.

[66] Tr., Vol 7, page 1077, lines 26-28 (Dr. Alexander, SCE) (May 17, 2007).

[67] Tr., Vol. 7, page 1078 (Dr. Alexander, SCE) (May 17, 2007).

[68] 35 Bcf is for core reliability and balancing agreed to by parties, including DRA, in the Comprehensive Settlement Agreement. Decision No. 01-12-018, Section III.D(2), mimeo p. 58.

[69] Since 35 Bcf of the 55 Bcf is for core reliability and balancing, the balance could be used for arbitrage. Decision No. 01-12-018, Section III.D(2), mimeo p. 58.

[70] 4.5 Bcf is the approximate amount level needed for core reliability. Tr., Vol. 7, page 1078 (Dr. Alexander, SCE) (May 17, 2007).

[71] Since 4.5 Bcf is the approximate amount level needed for core reliability, the balance could be used for arbitrage. Tr., Vol. 7, page 1078 (Dr. Alexander, SCE) (May 17, 2007).

Given DRA's belief that 35 Bcf of storage inventory was sufficient for SoCalGas' core reliability and given that SDG&E's total storage inventory (for reliability, balancing, and arbitrage) is 9 Bcf, SCE submits that the Applicants have demonstrated that the proposed 70 Bcf combined core storage inventory level is more than adequate for core reliability.[72]

B. Assigning Too Much Capacity To The Core Creates An Inefficient Market, Which Harms Core And Noncore Customers

SCE again emphasizes that the Applicants believe that the core should have the right level of capacity needed to ensure reliability. However, assigning too much capacity to the combined core is harmful because it creates an inefficient market, which hurts both core and noncore customers. As indicated by SCE witness Dr. Alexander, if the combined core holds more capacity than it needs, then the core may be spending more for capacity than it needs to.[73]

Second, as the amount of capacity allocated to the core increases, the amount left to be sold through the unbundled storage program to noncore customer decreases, which ultimately hurts all customers (including core) as well as the Southern California economy. Dr. Alexander observed that a shortage in the unbundled storage program can not only increase the price of storage to noncore customers, but also increase border gas prices for all customers, increase the cost of goods for all customers, and negatively impacts the Southern California economy.[74] Indeed, the storage capacity in the unbundled storage program has sold out in each of the last two seasons.[75] The CPUC and CEC have expressed concerns about storage capacity constraints as well.[76]

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[72] Approximately 40 Bcf of the 70 Bcf would be necessary for core reliability and balancing, with the remaining 30 Bcf used for price arbitrage.

[73] Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), page 10.

[74] Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pages 10-11.

[75] Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), page 10.

[76] See Tr., Vol. 7, page 1083, lines 22-25 (Dr. Alexander, SCE) (referring to the page 13, key item 4 of the "Implementation Roadmap for Energy Policies, the Energy Action Plan II").

Finally, insufficient injection capacity for customers increases the severity of Operational Flow Orders ("OFOs"), which results in inefficient market transactions as customers are forced to sell gas at a loss and increase price volatility.[77] Given the frequency of OFOs recently called by SoCalGas,[78] the Commission should ensure that the combined core injection level is not excessive and the injection inventory for noncore customers is not unduly limited. Indeed, as explained by Dr. Alexander, an additional 42 MMcf/day of injection capacity[79] for noncore customers would lessen the severity of the problems created by OFOs by permitting customers to store rather than dump gas and thereby would decrease price volatility.[80]

V.

WINTER HEDGES SHOULD BE EXCLUDED FROM THE GCIM

DRA opposes the provision in the Omnibus Settlement that provides that beginning with the winter of 2007-2008, all financial transactions used by SoCalGas to hedge natural gas prices for any portion of the November through March period ("winter hedges") will be excluded from the GCIM.[81] Contrary to DRA's assertion that the removal of winter hedges is a "profound change to Commission policy,"[82] the Commission is quite clear that it believes that hedging should be excluded from the gas utilities' gas incentive mechanisms, as demonstrated in its four most recent decisions on this issue.[83]

In Decision No. 05-10-015 and Decision No. 05-10-043, the Commission approved the relief request by PG&E, SoCalGas, and SDG&E to exclude the costs and benefits of winter

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[77] Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pages 14-17.

[78] Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), page 12.

[79] The Applicants' proposal would free up an additional 13 Bcf (83 Bcf -70 Bcf) of inventory capacity for noncore use, and an additional 42 MMcf/day (369 MMcf/day – 327 MMcf/day) of injection capacity. Exhibit 60, Direct Testimony of Dr. Alexander, page 14.

[80] Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pages 14 - 17.

[81] Exhibit 19, Appendix B, Omnibus Settlement, Section 16 on page B-4.

[82] Exhibit 71, Direct Testimony of Sabino (DRA), p. 31.

[83] See Decision Nos. 05-10-015 (relating to PG&E), Decision No. 05-10-043 (relating to SoCalGas and SDG&E for the 2005-2006 Winter Hedge program), Decision No. 06-08-027 (relating to PG&E, SoCalGas, and SDG&E), and Decision No. 07-06-013 (relating to PG&E).

hedging from their incentive mechanisms because the much higher levels of gas costs and increased price volatility had increased the costs of hedging to such a level that continued inclusion of the hedges would have constituted a strong disincentive on the part of the utilities to hedge winter gas costs at an appropriate level.[84] The Commission agreed stating, "It is critically important that the utilities have the flexibility, in the coming months, to make those hedging decision quickly and that they not be constrained by disincentives to do so."[85]

Subsequently, in Decision No. 06-08-027, the Commission stated, "We find that the existing incentive mechanisms may not be designed to accommodate hedging activities that might be reasonable given changing market conditions."[86] It concluded that "[t]he existing incentive mechanisms may not be structured in ways to motivate optimal purchases of hedging instruments on behalf of ratepayers."[87] More recently, notwithstanding a proposed decision to the contrary, the Commission in Decision No. 07-06-013 recently approved a settlement (which DRA was a signatory to) which provided that hedging should remain outside of PG&E's gas incentive mechanisms.[88]

The Commission should apply its long standing principle and continue to exclude gas hedging from SoCalGas and SDG&E's gas cost incentive mechanisms. As indicated above, the gas incentive mechanism was not designed to accommodate hedging activities in a changing market. Further, as noted by SCE witness Dr. Alexander, the intention of the gas cost incentive mechanism is to provide the gas utility with an incentive to buy gas as inexpensively as possible for its core customers. In practice, that relates to buying gas at less than a monthly benchmark price.[89] Gas hedging is not consistent with the goal of a gas cost incentive mechanism in that hedging lowers <u>volatility</u>, not costs. A pointed out by SCE witness Dr. Alexander, hedging,

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84 Exhibit 2, Direct Testimony of Van Lierop (SoCalGas/SDG&E), page 6.
85 Decision No. 05-10-043, mimeo p. 11.
86 Decision No. 06-08-027, mimeo p. 14.
87 Decision No. 06-08-027, mimeo p. 20 (Finding of Fact 8).
88 Decision No. 07-06-013, mimeo pages 9 – 10.
89 Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pages 19 – 20.

which acts like an insurance policy, actually raises the utilities' cost of gas and should not be included with SoCalGas and SDG&E's gas cost incentive mechanisms.[90]

VI.

CONCLUSION

Wherefore, for the above reasons, the Commission should approve the changes to the operational practices and services offered by SoCalGas and SDG&E as a result of the Omnibus Settlement Agreement and the Continental Forge Settlement Agreement.

Respectfully submitted,

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June 25, 2007

[90] Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), page 20.

CERTIFICATE OF SERVICE

I hereby certify that, pursuant to the Commission's Rules of Practice and Procedure, I have this day served a true copy of **OPENING BRIEF OF SOUTHERN CALIFORNIA EDISON COMPANY (U338-E)** on all parties identified on the attached service list(s). Service was effected by one or more means indicated below:

> Transmitting the copies via e-mail to all parties who have provided an e-mail address. First class mail will be used if electronic service cannot be effectuated.

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